Office-Supreme Court, U.S.
FILED
APR 22 1983
ALEXANDER L. STEVAS,
CLERK

No. 82-1516

In the Supreme Court of the United States

OCTOBER TERM, 1982

SEA PINES COMPANY, PETITIONER

v.

FEDERAL DEPOSIT INSURANCE CORPORATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

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Petitioner seeks review of the decision below holding that in the circumstances of this case the district court should have pierced the corporate veil to allow respondent, the Federal Deposit Insurance Corporation, to collect from petitioner the indebtedness owed by its 90%-owned subsidiary.

1. The evidence showed (Pet. App. 1a-5a) that in early 1973 American Bank & Trust ("AB&T") extended a loan to Point South, Inc., a 90%-owned subsidiary of petitioner Sea Pines Company.[1] The purpose of the loan was to finance construction of a reception center on the subsidiary's property. In return AB&T received a $250,000 note

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[1]Point South, Inc. was one of a number of subsidiary corporations used by petitioner. It was initially capitalized with $1,000 by two of the three members of petitioner's executive committee. See Pet. App. 2a. Petitioner and Point South had common directors and officers, and petitioner financed Point South in large part (*id.* at 7a).

secured by a mortgage. In August of that year Point South entered into a sale-leaseback transaction in which it sold the reception center to a limited partnership and leased it back. Petitioner formally guaranteed the rent payable by the subsidiary to the limited partnership.

The following year, in October 1974, petitioner and Point South, acting through their common directors, mortgaged the subsidiary's equity in a 76-acre tract worth $350,000 as collateral for loans to petitioner. Point South was to receive $8,000 as consideration for this transaction. In May 1975 the common directors of petitioner and Point South arranged for cancellation of the 1973 sale-leaseback transaction involving the reception center. Point South repurchased the building and cancelled the note and mortgage issued by the limited partnership. Point South also released petitioner from its agreement to guarantee rent payments on the reception center. During the period in which these latter transactions occurred, Point South was insolvent. In February 1973, Point South's balance sheet showed assets in excess of $2.5 million with a total net worth of $65,000 ($1,000 of capital stock and $64,000 of retained earnings). By February 1974, the highly leveraged subsidiary was insolvent, with a negative net worth of $177,000; by February 1975 the subsidiary had a negative net worth of $1,949,000 (Pet. App. 4a-5a). Point South continued to be insolvent thereafter.

AB&T subsequently failed. The FDIC acquired from the receiver the assets of AB&T, including the $250,000 note and mortgage of Point South. FDIC foreclosed on the mortgage and obtained a deficiency judgment of $196,680.08 against Point South. In October 1978, FDIC sued petitioner to collect the indebtedness owed by Point South, contending that petitioner had guaranteed the debt to AB&T, and, alternatively, that under the circumstances, it was appropriate to pierce the corporate veil to permit recovery from the

parent for the debt of the subsidiary. The district court ruled in favor of petitioner (Pet. App. 14a-29a), concluding that there had been no guarantee of the loan and that, despite the existence of a number of factors that would tend to justify disregard of the separate corporate existence of Point South, the necessary element of fundamental unfairness was lacking.

The court of appeals reversed (Pet. App. 1a-12a). The court of appeals found it unnecessary to determine whether petitioner had guaranteed the loan of its subsidiary, since it concluded that under the circumstances the district court should have pierced the corporate veil to permit recovery against petitioner. The court of appeals noted (*id.* at 7a) that the district court "found that a sufficient number of the factors to pierce the corporate veil were present except the existence of injustice or fundamental unfairness." The court of appeals found such injustice and fundamental unfairness in the fact that the common directors of petitioner and Point South had violated their fiduciary duty to the creditors of the subsidiary by using the subsidiary and its assets for the benefit of the parent during the period in which the subsidiary was insolvent. The court cited the action of the common directors in mortgaging the only unencumbered asset of Point South in order to benefit petitioner, thus depriving the subsidiary of an asset with equity of $350,000, and in cancelling the sale-leaseback transaction, which effectively ended petitioner's guarantee of rent payments that would have been used to continue payments on the AB&T mortgage. The court of appeals concluded that these breaches of fiduciary duty were sufficient to constitute the fundamental unfairness and injustice that, together with factors such as the common officers and directors and the undercapitalization of Point South, would justify piercing the corporate veil.

2. Petitioner contends that the court below overlooked relevant facts, particularly the history of the relationship between petitioner and Point South, and that it used an incorrect legal test that conflicts with an earlier decision of the Fourth Circuit. These contentions are without merit. The court below correctly concluded that petitioner's use of its subsidiary's assets for its own benefit during the period in which the subsidiary was insolvent justified piercing the corporate veil to permit FDIC to recover from petitioner for its subsidiary's indebtedness. That decision, which rests on application of established principles of corporate law, does not conflict with the decision of any other court of appeals or with any decision of this Court. Therefore, review by this Court is not warranted.

Petitioner contends (Pet. 3-6) that this case does not involve the sort of injustice or fundamental unfairness justifying disregard of the corporate entity. But as the court below pointed out (Pet. App. 9a-10a), it is well established that the directors of an insolvent corporation owe a fiduciary duty to creditors of the corporation and may not use the assets of the corporation to prefer themselves. Here the common directors of petitioner and Point South breached that duty by mortgaging the subsidiary's only unencumbered asset in order to benefit petitioner at a time when the subsidiary was insolvent. See *Koehler* v. *Black River Falls Iron Co.*, 67 U.S. (2 Black) 715, 718-721 (1862). Likewise, as petitioner's counsel admitted (see Pet. App. 11a), the cancellation of the sale-leaseback transaction in May 1975 was for the sole benefit of petitioner, with no benefit to the insolvent subsidiary or to creditors such as AB&T. These transactions clearly resulted in the sort of injustice and fundamental unfairness that, together with factors such as the common officers and directors and the undercapitalization of Point South, justifies disregard of the corporate entity under the settled principles of corporate law relied on by the court of appeals.

Petitioner urges that the court of appeals "completely overlook[ed] and ignore[d]" (Pet. 3) the facts before it, in particular that petitioner advanced large sums of money to Point South over a period of time. However, it is clear that the court of appeals did not ignore the facts; the court had the record before it, and its opinion reflects its familiarity with those facts. It was appropriate for the court to examine the period following issuance of the loan by AB&T and during which Point South became insolvent, since that is the period that is relevant to whether there was the injustice to AB&T, and to FDIC as its successor in interest, that would warrant piercing the corporate veil. The fact that petitioner may have been willing to cover the debts of its subsidiary to other creditors and in other periods does not alter the fundamental unfairness and injustice to AB&T and its successor in interest.[2]

Petitioner's contention (Pet. 3) that the decision below "overlooks" and conflicts with *DeWitt Truck Brokers, Inc.* v. *W. Ray Flemming Fruit Co.*, 540 F.2d 681 (4th Cir. 1976), is without merit. The court of appeals referred specifically to the *DeWitt* case and found that the district court had misconstrued it (Pet. App. 9a; *id.* at 7a, 12a). The court in *DeWitt* stated (540 F.2d at 684) that proof of "plain

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[2]The district court made no findings of fact concerning the alleged transfer of funds from petitioner to Point South, but instead relied on AB&T's knowledge of the control petitioner exercised over its subsidiary (Pet. App. 22a-24a).

Petitioner suggests (Pet. 5-6) that FDIC should have been limited to a pro rata recovery of any assets petitioner had received from Point South, since petitioner and one of its affiliates, Sea Pines Plantation Company, were "creditors" by virtue of their transfer of funds to Point South and thus were entitled to participate in Point South assets. Petitioner cites no authority for this suggestion, which appears on its face to be frivolous, and which petitioner apparently advances for the first time in this Court.

fraud" is not necessary in order to disregard the corporate entity, citing this Court's opinion in *Anderson* v. *Abbott*, 321 U.S. 349, 362 (1944). That statement is fully consistent with the conclusion of the court of appeals (Pet. App. 9a, 12a) in this case.[3] Moreover, even if there were a conflict between cases within the Fourth Circuit on this point, this would not be a matter that warrants the attention of this Court. See *Wisniewski* v. *United States*, 353 U.S. 901 (1957).

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[3]Petitioner also suggests (Pet. 3-4) that the decision below conflicts with the decisions of several other courts of appeals that hold that the corporate entity will be disregarded only in exceptional circumstances. There is no such conflict. The cases cited by petitioner are consistent with the conclusion of the court below that the corporate entity may be disregarded even when unfairness or injustice does not take the form of fraud. See *United States* v. *Martin*, 337 F.2d 171, 175 (8th Cir. 1964) (corporate entity will be disregarded when used as an intermediary to "perpetrate fraud or promote injustice"); *In re Gibraltor Amusements, Ltd.*, 291 F.2d 22, 24 (2d Cir.), cert. denied, 368 U.S. 925 (1961) (corporate veil will be pierced when corporate entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, and in some cases when the subsidiary is used as a mere conduit for the parent); *Chengelis* v. *Cenco Instruments Corp.*, 386 F.Supp. 862, 865 (W.D. Pa.), aff'd mem., 523 F.2d 1050 (3d Cir. 1975) (corporate entity may be disregarded in the case of "fraud or injustice akin to fraud"). See also *Farmers Feed & Supply Co.* v. *United States*, 267 F. Supp. 72, 76 (N.D. Iowa 1967) (corporate veil will not be pierced unless corporation is used as an intermediary to "perpetrate fraud or promote injustice"). While the courts in the cases cited by petitioner declined to pierce the corporate veil, it is significant that none of the cases involved a parent corporation that in effect had stripped the assets of an insolvent subsidiary for its own benefit. Thus, there is no indication that any of these courts would have decided the present case differently than the court below.

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

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APRIL 1983